Flexible-Cash Rents for Farmland

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Farmers face many business risks relating to production, prices, technological change, legal and social issues, and human resources. A tenant can share production and price risks with the landlord through a crop-share lease. This enables the landlord to share in higher or lower-than-expected yields and/or prices. However, the typical crop-share lease also requires the landlord to share the cost of fertilizer, seed, and chemicals and pay to have his share of the crop harvested. Income from such a share lease is usually considered as self-employment income for the landlord, which some landlords would prefer to avoid. A subsequent fact sheet in this series will address farm-rental tax issues.

In contrast, a flexible-cash lease will allow landowners to share some of these risks without becoming subject to self-employment taxes. And, like a fixed-cash lease, the tenant doesn't have to keep track of the landowner's share of expenses. Nor does the landowner have to make grain marketing decisions.

Flexible-cash rent usually pertains only to cropland, with fixed rents for buildings, farmstead facilities, and relatively minor acreages of pasture, hay, or woodland. Both parties need to agree on the amount of these "non-flexible" rents prior to start of the lease period. In addition, the flexible-cash rent keeps the landowner eligible for potential "windfall profits" should they happen.

Some disadvantages include the requirement of more records and a written lease agreement compared to a possible fixed-cash rent. In addition, the tenant should expect less income over time because he is transferring more of the risk to the landowner.

An Ohio 1999 research project revealed that at least 8 percent of cash leases had some flexibility provisions. A 1996 Ohio study revealed few flexible cash leases.

Types of Flexible Rents

There are a number of ways to create a flexible-cash rent arrangement including adjustments for crop price only, yield only, or based on both price and yield changes.

Flexing Rents for Price

At least four methods can be used to flex for price only:
>   1) Price ratio
>   2) Fixed quantity of commodity
>   3) Base rent with adjustments
>   4) Base rent with upward adjustments

Let's consider each method individually:

1) The *price ratio* method requires that a base rent be established then multiplied by a ratio of current price to base price. An example would be a base rent of $80/acre, expected base price of $2.50:

$$\$80 \times \frac{\text{Current Price (\$2.00)}}{\text{Base Price (\$2.50)}} = \$64.00$$

The current price would be determined at harvest time based on a multi-week average.

2) A simple way of flexing for price is to set rent at a *fixed number of bushels per acre*. The rent could then be paid, either in the actual commodity with the landowner doing his own marketing, or in cash with the tenant using an average price over several weeks at harvest. The range could be 20–33 percent of expected yield with higher rates on more productive ground.

3) A third method is to agree on a *base rent with adjustments* for prices outside a specified range. For example, a base rent of $80/per acre could be changed by $5 per acre for each 10¢ change in corn price outside a range of $1.80-$2.20. If the corn price was $2.75, the tenant would add $27.50 to the $80 base rent.

4) A *base rent with upward adjustments* would set a minimum rent that could not be lowered, but could be increased based on an increase in crop prices.

Flexing for Both Price and Yield

Four methods could also be used to flex for both price and yield. The first method here is to agree upon a *fixed share of the yield* as rent, regardless of the actual production. The lease might say 25 percent of the crop, paid either in the actual commodity or cash using the actual prices during the harvest period.

Leases that set rents only on either price or yield may actually increase a tenant's risk in some years. Adjustments for a combination of price and yield will more closely reflect net income at the crop.

A second way is to use the *ratio method* by using a formula of:

Base Rent x $\dfrac{\text{Current Price}}{\text{Base Price}}$ x $\dfrac{\text{Actual Yield}}{\text{Base Yield}}$

An example for soybeans might be:

$80 x $\dfrac{\$5.50}{\$6.00}$ x $\dfrac{45}{40}$ = $82.50 per acre

The base price is the expected harvest time price, while the base yield is a multi-year average.

A third method would be to agree upon a *stated percent of the crop value,* again calculated at harvest time. In the soybean example, 30 percent of $5.50 x 45 bushels = $74.25.

Table 1 shows the average cash rent paid in Iowa over 10 years as a percent of gross income each year, including government payments. Ohio does not have comparable data.

The final method is to set a *minimum base rent plus a share of any increased value of the crop* over a base expected gross receipt. Again, using a soybean example, the rent could be the base plus 30 percent of any crop value over $240/per acre.

Determining Yield

It is important to agree ahead of time on the procedure for determining the factors that will be used to calculate the final rent. These factors should be based on information that is available to both parties. Actual yields can be determined by:

- Weight tickets, if all the crop is sold or put into commercial storage
- Combine yield monitors or weigh wagons
- Storage bin capacity or on-farm sales

When crops stored on the farm are ultimately sold, any variation from the estimated yield can be used to adjust the rent for the following year. Estimated yields should be corrected to a standard moisture level, for example, 15.5 percent moisture for no. 2 yellow corn.

Table 1. Rent as percent of gross income

Year	Corn	Soybeans
1989	33%	38%
1990	33%	38%
1991	35%	42%
1992	33%	38%
1993	48%	49%
1994	32%	36%
1995	29%	36%
1996	31%	35%
1997	33%	36%
1998	42%	44%
Average	35%	39%

Source: William Edwards, Iowa State University

Government Payments

Because the purpose of a flexible lease is to adjust the amount of rent to reflect the income received from crops each year, payments received from participation in government programs should also be considered. If rent is to be calculated as a percentage of gross income, then gross income can include both crop sales and government program payments received or expected. For leases that include selling price in the rent calculation, income received from a loan deficiency payment or through an F.S.A. marketing loan can simply be included by using the local loan rate as the actual market price.

Actual Flexible-Cash Rent Leases

A 1999 survey in Iowa revealed these actual agreements being used:

Flexible Rent Based on Both Price and Yield

The most common type of flexible lease bases the final cash rent on some combination of actual yields and actual prices. In many cases, the rate is simply a percentage of the price times the yield (gross revenue). Some agreements also include government payments in the gross revenue, and some specify a maximum and/or minimum rent. Below are examples:

- One-third of the actual yield x the average market price at a designated grain terminal on the first of each month, plus one-third of the government loan deficiency payment. (Cerro Gordo County, Iowa)
- One-third of gross income based on actual yield and November 1 grain prices, and including F.A.I.R. payment. (Marshall County, Iowa)
- 35 percent of actual yields x average of best local price each Wednesday for November and December with a $100 minimum rent. (Buchanan County, Iowa)
- One-third of the crop valued at the local co-op price on December 15. (Wright County, Iowa)
- Base rent of $1 per CSR point, or 35 percent of the gross value of the crop and FSA payment if higher than base. (Benton County, Iowa)
- 35 percent of the gross revenue for soybeans and 30 percent of the gross revenue for corn. Price is established in the fall at a certain market. (Floyd County, Iowa)
- $125 x (actual price/$2.50) x (actual yield/140), plus half of F.S.A. transition payment. Price determined by the average of local elevator close on the second Monday of December-April. (Webster County, Iowa)
- 35 percent for corn and 37 percent for soybeans, times the actual yield times the average price on July 15, November 1, and February 1. There is a minimum and maximum rent per acre. (Benton County, Iowa)
- 37 percent x bushels harvested x November soybean closing price on the last trading day in October and the December corn closing price on the last trading day in November. Minimum rent of $85 of which two-thirds is paid in advance. (Bremer County, Iowa)

- Base rent of $80, plus one-third of corn bushels over 80 bushels per acre x price on December 15 price. (Iowa County, Iowa)

- $100 per acre plus one-third of corn yield over 100 bushels per acre x December 1 price at local elevator. (Cass County, Iowa)

- $115 minimum rent plus 34 percent of gross income over $337.50 for corn, based on November 1 actual yield and price. (Tama County, Iowa)

- Base rent of $80. Bonus of half of November 1 local soybean price for each bushel harvested over 40 bushels per acre and/or half of January 1 local corn price for each bushel harvested over 110 bushels per acre. (Howard County, Iowa)

Flexible Rent Based on Yield Only

Some flexible-lease agreements specify a base or minimum rent per acre plus a bonus based on the actual yields harvested. Below are examples:

- $100 plus $1 for every bushel harvested over 40 bushels of soybeans per acre. (Howard County, Iowa)

- $125/per acre plus 85¢ per bushel over 125 bushels per acre. Maximum rent of $150 per acre. (Greene County, Iowa)

- 85¢ per bushels of corn harvested. Range is $110-$150. (Kossuth County, Iowa)

- 90¢ x actual corn yield. (Boone County, Iowa)

- Base rent of $105/per acre, plus $1 for each bushel of corn over 105 per acre and/or $3 for each bushel of soybeans over 32 bushels per acre. Maximum of $145 for corn and $135 for soybeans. (Howard County, Iowa)

- $140 plus $1 per bushel of corn harvested over 140 bushels per acre. (Grundy County, Iowa)

Flexible Rent Based on Price Only

A few flexible-rent agreements base the final rent on price only. Alternatively, the rent may be defined as a fixed number of bushels. With these agreements, the tenant bears all of the yield risk. Crop insurance protection would be advisable in this type of lease. Below are some examples:

- Rent is 55 bushels of corn per acre. (Winneshiek County, Iowa)

- The value of 50 bushels of corn per acre with a minimum of $120. (Butler County, Iowa)

- Spring payment of $40–50 per acre plus fall payment of 22.5 bushels corn x average local corn price. (Pocahontas County, Iowa)

- 61–63 bushels of corn per acre and 21–25 bushels of soybeans per acre delivered to the owner. (Pocahontas County, Iowa)

Source: Edwards, *Ag Decision Maker,* Iowa State University (1999).

Summary

Once you have selected a potential type of flexible-cash rent, test it using a number of price and yield possibilities. Consider both a minimum and a maximum rent plus some type of crop insurance to control the risk. Under a flexible lease, a split payment may be used, the variable portion becomes the final payment with an advance fixed payment. Iowa examples may not fit Ohio conditions.

Flexible rents almost always require the agreement to be in writing. Details need to be agreed upon prior to the start of the lease term and be reviewed by an attorney for accuracy and completeness. Be sure to describe it in writing (with an example) and include it with the written lease. The following worksheet (developed by William Edwards, Iowa State) can help you start the negotiation process. Sample lease forms are available from your local OSU Extension office.

References

NCR75, NCR 76 – *Fixed & Flexible Cash Rental Arrangements for Your Farm, Lease Form*
Web-site: www.extension.umn.edu
Web-site: www.ag.ohio-state.edu
Edwards, William, *Flexible Farm Lease Arrangements,* FM-1724, June 1999, Iowa State University

Flexible-Lease Agreement Worksheet

Basic Information:	Corn	Soybeans
Expected yield—bushels per acre	_____ bu.	_____ bu.
Expected price—$ per bushel	$_____	$_____
Base rental rate—$ per acre	$_____	$_____
Expected U.S.D.A. payments—$ per acre	$_____	$_____

Type of Agreement (check one):   Corn   Soybeans

1. _____   **Share of Gross Income**
Percent of gross income to equal rent   _____%   _____%
(base rent divided by price x yield plus govt. payment)

2. _____   **Yield Adjustment Only**
Fixed price per bushel of actual yield $_____ $_____
Or, minimum yield,   _____ bu.   _____ bu.
And fixed price for each bushel over minimum $_____ $_____

3. _____   **Price Adjustment Only**
Fixed bushels to pay on   _____ bu.   _____ bu.

4. _____   **Base Rent plus Bonus**
Base rent $_____ $_____
Minimum gross income or tenant's costs $_____ $_____
Percent of gross income over the minimum added to $_____ $_____
    rent.

Explanations:

1. How will the price be determined (types 1, 3, and 4)? _____

_____

2. How will the yield be determined (types 1, 2, and 4)? _____

_____

3. How will the tenant's costs be determined (type 4)? _____

_____

4. What U.S.D.A. farm payments will be included (types 1 and 4)? _____

_____

5. Will crop insurance payments be included (types 1 and 4)? _____

_____

6. Will there be a minimum rent? A maximum rent? _____

_____

Source: William Edwards, Iowa State University

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